Bourse
de Montréal Inc.

CIRCULAR
April 23, 2003

REQUEST FOR COMMENTS

CAPITAL SHARE AND CONVERTIBLE AND EXERCISABLE SECURITY OFFSETS

AMENDMENTS TO ARTICLES 7202A AND 7213 AND ADDITION OF ARTICLES 7227 AND 7228

Summary

The Executive Committee of Bourse de Montréal Inc. (the "Bourse") approved amendments to articles 7202A and 7213 and the addition of articles 7227 and 7228 to the Rules of the Bourse. The proposed amendments and addition deal with margin and capital requirements for capital shares and convertible and exercisable securities offsets. The objective of the proposed amendments is to increase the number of permitted reduced margin and capital offset strategies for capital shares, convertible securities and exercisable securities. The proposed new offset combinations involve mainly short positions in capital shares or convertible or exercisable securities.

Process for Changes to the Rules

Bourse de Montréal Inc. is recognized as a self-regulatory organization ("SRO") by the Commission des valeurs mobilières du Québec (the "Commission"). In accordance with this recognition, the Bourse carries on activities as an exchange and as a SRO in Québec. In its capacity as a SRO, the Bourse assumes market regulation and broker-dealer regulation responsibilities. The broker-dealers regulated by the Bourse are its approved participants. The responsibility for regulating the market and the approved participants of the Bourse comes under the Regulatory Division of the Bourse (the "Division"). The Division carries on its activities as a distinct business unit separate from the other activities of the Bourse.

Circular no.: 051-2003

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The Division is under the authority of a Special Committee appointed by the Board of Directors of the Bourse. The Special Committee is empowered to recommend to the Board of Directors the approval or amendment of some aspects of the Rules and Policies of the Bourse governing approved participants, among which, the Rules and Policies relating to margin and capital requirements. The Board of Directors delegated to the Executive Committee of the Bourse its powers to approve or amend these Rules and Policies upon recommendation from the Special Committee. These changes are submitted to the Commission for approval.

Comments on the proposed amendments to articles 7202A and 7213 and on the addition of articles 7227 and 7228 must be submitted within 30 days following the date of publication of the present notice in the bulletin of the Commission. Please submit your comments to:

Ms. Joëlle Saint-Arnault
Vice-President, Legal Affairs and Secretary
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A copy of these comments shall also be forwarded to the Commission to:

Ms. Denise Brosseau
Secretary
Commission des valeurs mobilières du Québec
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E-mail: consultation-en-cours@cvmq.com

Appendices

For your information, you will find in the appendices an analysis document of the proposed rule amendments as well as the proposed regulatory text. The implementation date of the proposed amendments will be determined, if applicable, with the other Canadian self-regulatory organizations following approval by the Commission des valeurs mobilières du Québec.

Bourse de Montréal Inc.

CAPITAL SHARE AND CONVERTIBLE AND EXERCISABLE SECURITY OFFSETS

- **AMENDMENTS TO ARTICLES 7202A AND 7213**
- **ADDITION OF NEW ARTICLES 7227 AND 7228**

I OVERVIEW

A) Introduction

As part of a general review of permitted strategies for offsets, opportunities have been identified to increase the number of reduced margin offset strategies available involving capital shares, convertible securities and exercisable securities.

The proposed revised offset rules were developed taking into consideration:

- that there is significant risk reduction achieved with offsets involving a short position in a capital share or convertible security or exercisable security and a long position in the underlying security that is not currently addressed in the present rules; and
- that a number of these capital share and convertible or exercisable security issues are cash settled and, as a result, offset rules should be revised to consider the workout risk[1] associated with cash settled securities.

As workout risk is also a concern for total performance swaps, these proposals have been developed to be consistent with similar proposals for offsets involving total performance swaps. In this regard, please refer to proposal to amend articles 7226 and 7226A which was published in the Commission des valeurs mobilières Bulletin of April 17, 2003.

B) Current Rules

The current permitted strategies for offsets involving capital shares and convertible and exercisable securities, as set out in articles 7202A and 7213 of the Rules of the Bourse, only include strategies where the long position is convertible into or may be exchanged for the short position involved in the offset. So, for example, under the current rules, an offset involving a long position in a convertible security and an equivalent short position in the underlying security is permitted and an offset involving a short position in a convertible security and an equivalent long position in the underlying security is not permitted, even though both strategies are effective price hedges.

C) The Issue

As stated above the current offset strategies involving capital shares and convertible and exercisable securities only include strategies where the long position is convertible into or may be exchanged for the short position involved in the offset. This is because, even though offsets involving short positions in capital shares and convertible and exercisable securities are effective price hedges, they also have incremental workout risk to consider.

[1] One of the risk considerations with respect to any offset strategy is "workout risk". Workout risk is the risk either buy-in risk or sell-out risk or both associated with liquidating the positions involved in an offset strategy. For example, in the case of capital share offsets, the capital share position is generally cash settled so there is no workout risk but the related underlying security positions are subject to either buy-in risk or sell-out risk.

Looking again at the offset example involving a long position in a convertible security and an equivalent short position in the underlying security, the offset can be closed out at any time by exercising the conversion feature, receiving back the underlying security and delivering the underlying security position to close out the short underlying security position exposure. As a result, for this offset there would be no requirement to close out either position by either selling-out or buying-in the position in the market.

The same cannot be said for the offset involving a short position in a convertible security and an equivalent long position in the underlying security. This is because the conversion feature on a short convertible security cannot be exercised. As a result, for this offset there would be a requirement to close out both positions in the market by selling-out the long position and buying-in the short position in the market. Because of the presence of this workout risk, the present rules do not allow any margin reduction for this offset strategy, even though the strategy has the same price risk reduction characteristics as the previous example.

The proposed rule amendments seek to permit this type of offset strategy by specifically addressing the incremental workout risk inherent in the offset combination.

D) Objective

The main objective of these proposed amendments is to increase the number of permitted reduced margin offset strategies for capital shares, convertible securities and exercisable securities. This will be achieved by amending the existing offset rules to specifically address the presence of workout risk and by introducing new permitted offsets involving short positions in capital shares and convertible and exercisable securities.

E) Effect of Proposed Rules

Adoption of the proposed amendments will result in the increase of reduced margin offset strategies available involving capital shares, convertible securities and exercisable securities. These offsets are generally already permitted for use within other financial sectors. As a result, it is anticipated that there will be no negative impact of the proposed rules on market structure, competitiveness of approved participants versus non approved participants and costs of compliance.

II DETAILED ANALYSIS

A) Present Rules and Relevant History

The current offset rules for capital shares and convertible and exercisable securities are set out in articles 7202A and 7213 of the Rules of the Bourse. The rules generally only permit reduced margin offset combinations involving a long position in a capital share or convertible or exercisable security and a short position in the underlying security. These offset combinations, referred to as physical hedges, may be closed out at any time without liquidating the positions in the market as the long position may be converted into the underlying at any time and delivered to cover the short underlying security position.

The offset combinations involving a short position in a capital share or convertible or exercisable security and a long position in the underlying security are not considered to be a physical hedge and must be closed out by trading in and out of positions in the market referred to as workout risk. Historically, reduced margin offsets involving short positions in capital shares or convertible or exercisable securities have not been permitted.

B) Proposed Rules

As mentioned previously, the main objective of these amendments is to increase the number of offset rules for capital shares, convertible securities and exercisable securities. This will be achieved by introducing new permitted offsets involving short positions in capital shares and convertible and exercisable securities.

As explained previously, offset strategies involving a short position in a capital share or convertible security or exercisable security and a long position in the underlying security have the same price risk reduction characteristics as offsets currently permitted. The only incremental risk associated with these strategies is workout risk. The proposed offset rules for these offset strategies will specifically address the presence of workout risk. Attachment #1 is a summary of the proposed reduced margin offset strategies for capital shares, convertible securities and exercisable securities.

C) Issues and Alternatives Considered

No other alternatives to the rules being proposed were seriously considered. Alternative approaches such as the use of a value at risk model were determined not to be suitable due to their complexity and the fact that these models do not generally consider the unique offset risk factors such as workout risk.

D) Comparison with Similar Provisions

United Kingdom

In the United Kingdom, the Financial Services Authority (the "FSA") relies on the Position Risk Requirement calculation in determining the necessary capital to be provided for financial institution security positions. For example, in the case of a convertible security offset strategy, where the underlying security is an equity security, the FSA Rules allow that the convertible security may be included in the determination of the Equity Method Position Risk Requirement ("PRR") or the Equity Derivatives Method PRR. In determining the PRR under either of the above methods, the FSA Rules allow that the equivalent underlying security amount may be used for netting purposes.

In the United Kingdom, a firm may net or offset a long position against a short position only where the positions are in the same actual instrument including equity equivalent positions arising from convertible securities, derivatives and warrants in respect of that instrument.

United States

In the United States, reduced margin offsets involving convertible and exercisable securities are limited to those involving a long position in the exchangeable or convertible security and a short position in the underlying security.

E) Public Interest Objective

This proposal is designed to expand the number of permitted reduced margin offset strategies for capital shares, convertible securities and exercisable securities. As a result, the proposed amendments are considered to be in the public interest.

III COMMENTARY

A) Effectiveness

The proposed strategy based offsets will allow capital to be used more efficiently as well as provide more options for investors to manage market risk.

IV REFERENCES

- Rule Seven of Bourse de Montréal Inc.;
- NASD Rule 2520(e)(1);

APPENDIX A

- United Kingdom Financial Services Authority, Interim Prudential Sourcebook: Investment businesses, June 2000:
  - Rule 10-83, Netting of equity and equity equivalent positions before applying the equity method
  - Rule 10-91, Types of positions to be included under the equity derivatives method
  - Rule 10-102, Netting.

Capital Shares – Offset Matrix			
	Short capital share with cash conversion feature *	**Short capital share and short preferred share, both with a cash conversion feature** *	**Short underlying security**
Long capital share with cash conversion feature *	Offsetting positions in same security – no margin required		Sum of: (i) Capital share conversion loss; and (ii) Normal capital/margin required on preferred shares; and (iii) 20% of the normal capital/margin required on the underlying common shares **[Proposed article 7202A 2)]**
Long capital share and long preferred share, both with a cash conversion feature *		Offsetting positions in same security – no margin required	Sum of: (i) Combined conversion loss; and (ii) 20% of the normal capital/margin required on the underlying common shares **[Proposed article 7202A 3)]**
Long underlying security	Sum of: (i) Capital share conversion loss; and (ii) Normal capital/margin required on preferred shares; and (iii) 40% of the normal capital/margin required on the underlying common shares **[Proposed article 7202A 5)]**	Sum of: (i) Combined conversion loss; and (ii) 40% of the normal capital/margin required on the underlying common shares **[Proposed article 7202A 6)]**	Offsetting positions in same security – no margin required

* Generally, capital shares may only be converted into the underlying security by exercising a special annual retraction provision, provided sufficient quantities are held. As a result, it has been assumed that all capital shares have a cash conversion feature.

Convertibles – Offset Matrix

	Short convertible considered to be currently convertible	Short convertible considered to be currently convertible with cash conversion feature	Short convertible not considered currently convertible	Short underlying security
Long convertible considered to be currently convertible	Offsetting positions in same security – no margin required			Conversion loss **[Proposed article 7227 2) –** referred to as "physical hedge" as there is no requirement to buy-in or sell-out in the market to close out offset positions**]**
Long convertible considered to be currently convertible with cash conversion feature		Offsetting positions in same security – no margin required		Sum of: (i) Conversion loss; and (ii) 20% of normal margin for underlying **[Proposed article 7227 2) –** 20% requirement to cover short underlying buy-in risk**]**
Long convertible not considered currently convertible			Offsetting positions in same security – no margin required	Sum of: (i) Conversion loss; and (ii) 40% of normal margin for underlying **[Proposed article 7227 3) –** 40% requirement to cover buy-in and sell-out risk**]**
Long underlying security	Sum of: (i) Conversion loss; and (ii) 40% of normal margin for underlying **[Proposed article 7227 4) –** 40% requirement to cover buy-in and sell-out risk**]**			Offsetting positions in same security – no margin required

Exercisables (including warrants and rights) – Offset Matrix				
	Short exercisable considered to be currently exercisable	**Short exercisable considered to be currently exercisable with cash exercisable feature**	**Short exercisable not considered currently exercisable**	**Short underlying security**
Long exercisable considered to be currently exercisable	Offsetting positions in same security – no margin required			Sum of: (i) If client position, exercise payment; and (ii) Exercise loss **[Proposed article 7228 2)]**
Long exercisable considered to be currently exercisable with cash exercisable feature		Offsetting positions in same security – no margin required		Sum of: (i) If client position, exercise payment; and (ii) Exercise loss; and (iii) 20% of normal margin for underlying **[Proposed article 7228 2)]**
Long exercisable not considered currently exercisable			Offsetting positions in same security – no margin required	Sum of: (i) If client position, exercise payment; and (i) Exercise loss; and (ii) 40% of normal margin for underlying **[Proposed article 7228 3)]**
Long underlying security	Sum of: (i) If client position, exercise payment; and (ii) Exercise loss; and (iii) 40% of normal margin for underlying **[Proposed article 7228 4)]**			Offsetting positions in same security – no margin required

Section 7201 - 7250
Margins

7202A Margin Offsets on Capital Shares
(19.03.93, 01.04.93, 00.00.03)

1) For the purposes of ~~this~~ the present article:

a) "capital share" means a share issued by a split share company which represents all or a substantial portion of the capital appreciation portion of ~~a~~the underlying common share;

b) "capital share conversion loss" means any excess of the market value of the capital shares over the retraction value of the capital shares;

c) "combined conversion loss" means any excess of the combined market value of the capital and preferred shares over the combined retraction of value the capital and preferred shares;

~~b~~d) "preferred share" means a share issued by a split share company which represents all or a substantial portion of the dividend portion of ~~a~~ the underlying common share, and includes equity dividend shares of split share companies;

e) "retraction value" means:

A) for capital shares:

i) where the capital shares can be tendered to the split share company for retraction directly for the underlying common shares, at the option of the holder, the excess of the market value of the underlying common shares received over the retraction cash payment to be made when retraction of the capital shares takes place;

ii) where the capital shares cannot be tendered to the split share company for retraction directly for the underlying common shares, at the option of the holder, the retraction cash payment to be received when retraction of the capital shares takes place;

B) for capital shares and preferred shares in combination:

i) where the capital shares and preferred shares can be tendered to the split share company for retraction directly for the underlying common shares, at the option of the holder, the market value of the underlying common shares received;

ii) where the capital shares and preferred shares cannot be tendered to the split share company for retraction directly for the underlying common shares, at the option of the holder, the retraction cash payment to be received when retraction of the capital and preferred shares takes place;

~~e~~f) "split share company" means a corporation formed for the sole purpose of acquiring underlying common shares and issuing its own capital shares based on all or a substantial portion of the capital appreciation portion and its own preferred shares based on all or a substantial portion of the dividend income portion of such underlying common shares~~;~~.

d) ~~"corresponding" means, in respect of capital shares and preferred shares, the capital shares and preferred shares issued by the same split share company;~~

e) ~~"equivalent" means, in respect of capital shares, the number of capital shares issued by a split share company for each underlying common share held by the split share company. In calculating the number of capital shares that are equivalent to more than one common share, the number of capital shares issued per common share must be multiplied by the number of common shares that are the subject of the calculations;~~

f) ~~"identical" means, in respect of common shares, common shares issued by the same issuer;~~

g) ~~"combination exchange penalty amount" means, where applicable, the incremental amount~~ required to be paid to the split share company in order to exchange the combination of a ~~corresponding capital share and preferred share for the underlying common share, multiplied by the number of such combinations held;~~

h) ~~"capital share penalty amount" means the capital share intrinsic value, less the exercise value;~~

i) ~~"short position in options" or "short options" means a position in which a call has been written;~~

j) ~~"a long position in capital shares which is covered by a short position in common shares" means:~~

   i) ~~the equivalent number of capital shares are held long as the number of common shares held short, and~~

   ii) ~~the short common shares are identical to the common shares underlying the long capital shares;~~

k) ~~"a long position in capital shares which is covered by a short position in options" means:~~

   i) ~~the equivalent number of capital shares are held long as the number of common shares underlying the short options; and~~

   ii) ~~the common shares underlying the short options are identical to the common shares underlying the long capital shares;~~

l) ~~"exercise value" means the capital share retraction price, as defined in the prospectus of each split share company, multiplied by the number of capital shares held by a member or customer, or where no such definition is included, means the capital share intrinsic value;~~

m) ~~"prospectus" means the prospectus issued by a split share company to qualify its capital shares and preferred shares for distribution;~~

n) ~~"underlying" means, in respect of common shares, the common shares of a company that are purchased by a split share company to hold as securities on which the capital shares and the preferred shares of such split share company are based;~~

~~o) "capital share intrinsic value" means the sum resulting when the number of capital shares held by a member or customer is multiplied by the product obtained by the net asset value of the split share company divided by the number of outstanding capital shares of the split share company at the time of calculation, less the market value of a preferred share of the split share company at that time;~~

~~p) "net asset value" means the net asset value of a split share company as defined in the prospectus of that split share company, and where not so defined, means the value of the assets of the split share company less its liabilities;~~

(New point 2) below)

~~2) a) Subject to sub-paragraphs b) and c) of this paragraph where a member's or a customer's long position in capital shares is covered by a short position in common shares, the margin required~~ must be equal to the sum of:

~~i) the capital share penalty amount;~~

~~ii) 130% of the market value of the corresponding preferred shares for a customer, or 25% for a member; and~~

~~iii) where the capital share cannot be tendered to the split share company for retraction directly for the underlying common share at the option of the capital shareholder, the margin otherwise required pursuant to this sub-paragraph a) must be increased by an amount equal to 5% of the market value of the common shares;~~

~~but in no case may the total margin required be less than zero.~~

~~b) The margin required pursuant to this paragraph 2) must not be greater than 25% of the market value of the common shares if, in the case of a member's position, clause 2) a) iii) does not apply.~~

~~c) The margin required pursuant to this paragraph 2) must not be greater than:~~

~~i) 130% of the market value of the common shares in respect of a customer's position; or~~

~~ii) 30% in respect of a member's position, where clause 2) a) iii) applies.~~

2) Long capital shares and short common shares

Where capital shares are carried long in an account and the account is also short an equivalent number of common shares, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the sum of:

i) the lesser of:

a) the sum of:

I) the capital share conversion loss, if any; and

II) the normal capital required (margin required in the case of client account positions) on the equivalent number of preferred shares;

or

b) the normal capital required (margin required in the case of client account positions) on the underlying common shares;

and

ii) where the capital shares cannot be tendered to the split share company for retraction directly for the underlying common shares at the option of the holder, 20% of the normal capital required (margin required in the case of client account positions) on the underlying common shares.

(New point 3) below)

~~3) a) Subject to sub-paragraphs b) and c) of this paragraph 3), where a member's or a customer's long position in capital shares is covered by a short position in common shares, and the member or customer also owns identical preferred shares equal to the number of capital shares owned, the total margin required for all three securities must be:~~

~~i) subject to clause ii), the market value of the capital shares less the exercise value of the capital shares, plus the combination exchange penalty amount; or~~

~~ii) where the capital share cannot be tendered to the split share company for retraction directly for the underlying common share at the option of the capital shareholder, the margin otherwise required pursuant to clause i) must be increased by an amount equal to 5% of the market value of the common shares.~~

~~In no case, the total margin required may be less than zero.~~

~~b) The margin required pursuant to this paragraph 3) must not be greater than 25% of the market value of the common shares where, in respect of a member's position, clause 3) a) ii) does not apply.~~

~~c) The margin required pursuant to this paragraph 3) must not be greater than:~~

~~i) 130% of the market value of the common shares in respect of a customer's position; or~~

~~ii) 30% in respect of a member's position, where clause 3) a) ii) applies.~~

3) Long capital shares, long preferred shares and short common shares

Where both capital shares and an equivalent number of preferred shares are carried long in an account and the account is also short an equivalent number of common shares, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the sum of:

i) the lesser of:

a) combined conversion loss, if any; or

b) the normal capital required (margin required in the case of client account positions) on the underlying common shares;

and

ii) where the capital shares and preferred shares cannot be tendered to the split share company for retraction directly for the underlying common share, at the option of the holder, 20% of the normal capital required (margin required in the case of client account positions) on the underlying common shares.

4) Long capital shares and short call options

Where ~~a~~ capital shares ~~is~~ are carried long ~~for a member's or customer's~~ in an account and the account is also short an equivalent number of call options expiring on or before the redemption date ~~of expiration~~ of the ~~long~~ capital share, ~~and written on the same number and class of shares underlying the capital share~~, the capital and margin ~~required~~ requirements, for approved participant and client account positions respectively, ~~on the short option~~ must be ~~the lesser~~ equal to the sum of:

~~a) the margin required pursuant to article 11203 in respect of a client's position or pursuant to article 11227 in respect of a member's position; or~~

~~b) the amount, if any, by which~~

~~i) the excess of the market value of the underlying common shares over the exercise value of the capital shares, plus an amount equal to 5% of the market value of the common shares, if the capital shares cannot be tendered to the split share company for retraction directly for the~~

~~underlying common shares at the option of the capital shareholder; exceeds~~

~~ii) the exercise price of the short call, multiplied by the unit of trading of the call option.~~

i) the lesser of:

a) the normal capital required (margin required in the case of client account positions) on the underlying common shares; or

b) any excess of the aggregate exercise value of the call options over the normal loan value of the underlying common shares;

and

ii) the capital share conversion loss, if any; and

iii) where the capital share cannot be tendered to the split share company for retraction directly for the underlying common shares at the option of the holder, 20% of the normal capital required (margin required in the case of client account positions) in the underlying common shares.

(New point 5) below)

~~5) The margin requirements of the present article are not applicable to PEACs and SPECs securities for which specific margin requirements are provided for in paragraph 13 of article 7213.~~

5) Long common shares and short capital shares

Where common shares are carried long in an account and the account is also short an equivalent number of capital shares, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the greater of:

i) the sum of:

a) the capital share conversion loss, if any; and

b) the normal capital required (margin required in the case of client account positions) on the equivalent number of preferred shares; and

c) 40% of the normal capital required (margin required in the case of client account positions) on the underlying common shares.

or

ii) the normal capital required (margin required in the case of client account positions) on the underlying common shares.

6) Long common shares, short capital shares and short preferred shares

Where common shares are carried long in an account and the account is also short both an equivalent number of capital shares and an equivalent number of preferred shares, the capital and margin requirements, for approved participants and client account positions respectively, must be equal to the sum of:

i) the lesser of:

a) combined conversion loss, if any; or

b) the normal capital required (margin required in the case of client account positions) on the underlying common shares;

and

ii) where the capital and preferred shares cannot be tendered to the split share company for retraction directly for the underlying common share at the option of the holder, 40% of the normal capital required (margin required in the case of customer account positions) on the underlying common shares.

7213 Exceptions to Margin Rules
(30.11.86, 15.12.86, 01.06.88, 01.01.92, 15.01.93, 10.05.93, 01.04.93, 25.02.94, 12.03.97, 21.12.98, 29.08.01, 00.00.03)

(Point 14 of art 7213 is replaced by articles 7227 and 7228)
~~14) Margin offsets for convertible securities~~

~~a) Where a member~~

~~i) holds a short position in the securities of an issuer; and~~

ii) holds a long position in securities which are currently convertible or exchangeable into the ~~same class and at least the same number of securities referred to in clause i),~~

~~the margin required must be the excess of the market value of the long position over the market value of the securities carried short. Any residual net credit money balance of the market values of the offsetting positions may not be used to reduce margin otherwise required on the long of short position remaining unhedged after applying the foregoing offset. Where the securities representing the long position held by the member are not convertible or exchangeable until the expiry of a specific period of time but the member has entered into a written, legally enforceable agreement, pursuant to which it has borrowed securities of the same class as those of the short position which do not have to be returned until the expiration of the period of time until conversion or exchange, the foregoing offset may be applied as if the securities representing the long position were currently convertible or exchangeable.~~

~~b) Where a member~~

~~i) holds a short position in the securities of an issuer; and~~

~~ii) holds a long position in warrants, rights, shares, instalment receipts or other securities pursuant to the terms of which the holder is entitled to acquire the same class and at least the same number of securities referred to in clause (i),~~

~~the margin required must be equal to the aggregate of the subscription price or other cost or charge payable in connection with the acquisition of the securities pursuant to the warrant, right, share, instalment receipt or other security plus (or minus, if a negative) the difference between the aggregate market value of the warrant, right, share, receipt or other security and the market value of the security which may be so acquired.~~

~~c) Offsets in respect of the accounts of customers with positions as described in either subparagraphs a) or b) above are permitted in the circumstances provided in such subparagraphs. The margin required, in respect of the accounts of customers with such positions, must be equal to the difference between the market value of the long position and the market value of the positions carried short, plus the aggregate of the subscription price or other cost or charge payable in connection with the acquisition of the securities pursuant to the relevant warrant, right, share, instalment receipt or other security.~~

7227 Margin Offsets on Convertible Securities

1) For the purpose of the present article:

a) "conversion loss" means any excess of the market value of the convertible securities over the market value of the equivalent number of underlying securities;

b) "convertible security" means a convertible security, exchangeable security or any other security that entitles the holder to acquire another security, the underlying security, upon exercising a conversion or exchange feature;

c) "currently convertible" means a security that is either:

A) convertible into another security, the underlying security, either currently or within 20 business days, provided all legal requirements have been met and all regulatory, competition bureau and court approvals to proceed with the merger, acquisition, spin-off or other security related reorganization have been received; or

B) convertible into another security, the underlying security, after the expiry of a specific period, and the approved participant or client has entered into a term securities borrowing agreement. The agreement must be a written, legally enforceable agreement enabling the approved participant or client to borrow the underlying securities for the entire period from the current date until the expiry of the specific period until conversion;

d) "Newco securities" means securities of a successor issuer or issuers resulting from an amalgamation, acquisition, spin-off or any other securities related reorganization transaction;

e) "Oldco securities" means securities of a predecessor issuer or issuers resulting from an amalgamation, acquisition, spin-off or any other securities related reorganization transaction;

f) "underlying security" means the security, which is received upon exercising the conversion or exchange feature of a convertible security.

2) Long convertible securities considered "currently convertible" and short underlying securities

Where convertible securities are held long in an account and such securities are currently convertible and the account is also short an equivalent number of underlying securities, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the sum of:

i) the conversion loss, if any; and

ii) where the convertible security cannot be converted directly into the underlying security, at the option of the holder, 20% of the normal capital required (margin required in the case of client account positions) on the underlying securities.

3) Long convertible securities not considered "currently convertible" and short underlying securities

Where convertible securities are held in an account and such securities are not currently convertible and the account is also short an equivalent number of underlying securities, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the sum of:

i) the conversion loss, if any; and

ii) 20% of the normal capital required (margin required in the case of client account positions) on the underlying securities, to cover the sell-out risk associated with holding convertible securities not considered to be "currently convertible"; and

iii) where the convertible security cannot be converted directly into the underlying security, at the option of the holder, 20% of the normal capital required (margin required in the case of client account positions) on the underlying securities.

4) Short convertible securities and long underlying securities

Where convertible securities are held short in an account and the account is also long an equivalent number of underlying securities, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the sum of:

i) the conversion loss, if any; and

ii) 40% of the normal capital required (margin required in the case of client account positions) on the underlying securities.

5) Long "Oldco securities" and short "Newco securities" relating to an amalgamation, acquisition, spin-off or any other securities related reorganization transaction

i) Where, pursuant to a securities related reorganization involving predecessor and successor issuers, Oldco securities are held long in an account, the account is also short an equivalent number of Newco securities, and the conditions set out in clause ii) are met, the capital and margin requirements for approved participant and client account positions, respectively, must be the excess of the combined market value of the Oldco securities over the combined market value of the Newco securities, if any.

ii) The offset described in subparagraph i) above may be taken where all legal requirements have been met and all regulatory, competition bureau and court approvals to proceed with the merger, acquisition, spin-off or other security related reorganization have been received and where the Oldco securities will be cancelled and replaced by an equivalent number of Newco securities within 20 business days.

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1) For the purpose of the present article:

a) "exercise loss" means any excess of combined sum of the market value of the exercisable securities and the exercise or subscription payment, over the market value of the equivalent number of underlying securities;

b) "exercisable security" means a warrant, right, instalment receipt or any other security that entitles the holder to acquire another security, the underlying security, upon making an exercise or subscription payment;

c) "currently exercisable" means a security that is either:

A) exercisable into another security, the underlying security, either currently or within 20 business days, provided all legal requirements have been met and all regulatory, competition bureau and court approvals to proceed with exercising have been received; or

B) exercisable into another security, the underlying security, on a future date, and the approved participant or client has entered into a term securities borrowing agreement. The agreement must be a written, legally enforceable agreement enabling the approved participant or client to borrow the underlying securities for the entire period from the current date until the exercise or subscription date;

d) "underlying security" means the security, which is received upon invoking the exercise feature of an exercisable security.

2) Long exercisable securities considered "currently exercisable" and short underlying securities

Where exercisable securities are held long in an account and such securities are currently exercisable and the account is also short an equivalent number of underlying securities, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the sum of:

i) in the case of client account positions, the amount of the exercise or subscription payment; and

ii) the exercise loss, if any; and

iii) where the exercisable security cannot be exercised directly into the underlying security, at the option of the holder, 20% of the normal capital required (margin required in the case of client account positions) on the underlying securities.

3) Long exercisable securities not considered "currently exercisable" and short underlying securities

Where exercisable securities are held long in an account and such securities are not currently exercisable and the account is also short an equivalent number of underlying securities, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the sum of:

i) in the case of client account positions, the amount of the exercise or subscription payment; and

ii) the exercise loss, if any; and

iii) 20% of the normal capital required (margin required in the case of client account positions) on the underlying securities, to cover the sell-out risk associated with holding exercisable securities not considered to be "currently exercisable"; and

iv) where the exercisable security cannot be converted directly into the underlying security, at the option of the holder, 20% of the normal capital required (margin required in the case of client account positions) on the underlying securities.

4) Short exercisable securities and long underlying securities

Where exercisable securities are held short in an account and the account is also long an equivalent number of underlying securities, the capital and margin requirements, for approved participant and client account positions respectively, must be equal to the sum of:

i) in the case of client account positions, the amount of the exercise or subscription payment; and

ii) the exercise loss, if any; and

iii) 40% of the normal capital required (margin required in the case of client account positions) on the underlying securities.